

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

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PLR-122642-08

Date:

September 11, 2008

LEGEND

Distributing =

State X =

Date 1 =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

Shareholder 5 =

Shareholder 6 =

Business A =

LLC =

Controlled 1 =

Controlled 2 =

Controlled 3 =

Asset A =

Dear :

This letter responds to your May 12, 2008, letter requesting rulings as to the federal income tax consequences of a series of proposed transactions. The information provided in that request and in later correspondence is summarized below.

The rulings contained in this letter are based upon facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the proposed transactions described below: (i) satisfy the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations; (ii) are used principally as a device for the distribution of the earnings and profits of a distributing or controlled corporation or both (see § 355(a)(1)(B) of the Internal Revenue Code and § 1.355-2(d)); or (iii) are part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in a distributing or controlled corporation (see § 355(e) and § 1.355-7).

SUMMARY OF FACTS

Distributing is a State X corporation that was organized as a subchapter C corporation on Date 1. Distributing has one class of common stock, which is owned individually and

in equal proportion by Shareholder 1, Shareholder 2, Shareholder 3, Shareholder 4, Shareholder 5, and Shareholder 6. Shareholder 1 and Shareholder 2 collectively form "Group 1," Shareholder 3 and Shareholder 4 collectively form "Group 2," and Shareholder 5 and Shareholder 6 collectively form "Group 3." Distributing owns all of the ownership interests in LLC, a newly-formed entity disregarded as an entity separate from its owner for federal income tax purposes, which was created for the purpose of carrying out the Proposed Transactions (described below).

Distributing is directly engaged in Business A. Distributing has submitted financial information which indicates that Business A has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

PROPOSED TRANSACTIONS

For what are represented to be valid business reasons, Distributing has proposed the following transactions (the "Proposed Transactions"):

- (i) Distributing will create Controlled 1, Controlled 2, and Controlled 3 (collectively, the "Controlled Corporations").
- (ii) Distributing will transfer substantially all of its assets other than Asset A to LLC in constructive exchange for ownership interests in LLC.
- (iii) Distributing will divide Asset A and transfer one-third of Asset A and one-third of its ownership interests in LLC to each of Controlled 1, Controlled 2, and Controlled 3 in exchange for all of the stock of each of the Controlled Corporations and the assumption by each of the Controlled Corporations of the liabilities related to the assets transferred (the "Contributions"). Upon the contribution of the LLC interests to the Controlled Corporations, LLC will convert from a disregarded entity to an entity taxable as a partnership.
- (iv) Distributing will distribute half of the stock of Controlled 1 to each of Shareholder 1 and 2, half of the stock of Controlled 2 to each of Shareholder 3 and 4, and half of the stock of Controlled 3 to each of Shareholder 5 and 6, in exchange for all of the Distributing stock held by each Shareholder (the "Distributions").
- (v) Each of the Controlled Corporations will elect to be taxed as a subchapter S corporation.
- (vi) After the Distributions, Distributing will liquidate.

- (vii) The Contributions, the Distributions, and the S corporation elections will all occur on the same date.

After the Proposed Transactions, each Controlled Corporation will be managed independently by its own shareholder group, bear its own financial risk of loss, make its own financing decisions, and hedge its own risks.

REPRESENTATIONS

The taxpayer makes the following representations regarding the Proposed Transactions:

- (a) The fair market value of the Controlled 1, Controlled 2, or Controlled 3 stock, and other consideration, to be received by each Shareholder will be approximately equal to the fair market value of the Distributing stock surrendered by each Shareholder in the exchange.
- (b) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, an employee, or in any capacity other than that of a shareholder of Distributing.
- (c) The five years of financial information submitted on behalf of Distributing is representative of the corporation's present operation, and with regard to Distributing, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Neither Business A nor control of an entity conducting this business was acquired during the five-year period ending on the date of the Distributions in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part.
- (e) Following the Proposed Transactions, Controlled 1, Controlled 2, and Controlled 3, in conjunction with LLC, will each continue, independently and with their separate employees, the active conduct of their share of all integrated activities of Business A conducted by Distributing prior to consummation of the Proposed Transactions.

- (f) The Distributions will be carried out for the following corporate business purposes: (i) to provide substantial liability protection for each one-third portion of Asset A being contributed to Controlled 1, Controlled 2, and Controlled 3; and (ii) to provide each of the Group 1, Group 2, and Group 3 Shareholders control over the operation of Business A to be conducted on the portion of Asset A contributed to Controlled 1, Controlled 2, and Controlled 3, respectively. The Distributions are motivated, in whole or in substantial part, by one or more of these corporate business purposes.
- (g) The Proposed Transactions are not used principally as a device for the distribution of the earnings and profits of Distributing, Controlled 1, Controlled 2, or Controlled 3.
- (h) For purposes of § 355(d), immediately after the Distributions, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote or 50 percent or more of the total value of shares of all classes of Distributing stock that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distributions.
- (i) For purposes of § 355(d), immediately after the Distributions, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled 1, Controlled 2, or Controlled 3 stock entitled to vote, or 50 percent or more of the total value of the shares of all classes of Controlled 1, Controlled 2, or Controlled 3 stock, that was either (i) acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distributions, or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distributions.
- (j) The total adjusted bases and the fair market value of the assets transferred to each of Controlled 1, Controlled 2, and Controlled 3 by Distributing each equals or exceeds the sum of the liabilities assumed (within the meaning of § 357(d)) by each of Controlled 1, Controlled 2, and Controlled 3.
- (k) Any liabilities assumed (within the meaning of § 357(d)) by Controlled 1, Controlled 2, or Controlled 3 in the Contributions were incurred in the ordinary course of business and are associated with the assets being transferred.

- (l) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Proposed Transactions.
- (m) No intercorporate debt will exist between Distributing and Controlled 1, Controlled 2, or Controlled 3 at the time of, or subsequent to, the Distributions.
- (n) Payments made in connection with all continuing transactions, if any, between Controlled 1, Controlled 2, Controlled 3, and LLC will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (o) No parties to the Proposed Transactions are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (p) The Distributions are not part of a plan or series of related transactions (within the meaning of § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest (within the meaning of § 355(d)(4)) in either Distributing, Controlled 1, Controlled 2, or Controlled 3 (or any predecessor or successor of Distributing, Controlled 1, Controlled 2, or Controlled 3).
- (q) Immediately after the Distributions, neither Distributing, Controlled 1, Controlled 2, nor Controlled 3 will be a disqualified investment corporation (within the meaning of § 355(g)(2)(A)).
- (r) Controlled A, Controlled B, and Controlled C will each elect to be an S corporation pursuant to § 1362(a) on the same date as the Contributions from Distributing and the split-up of Business A. There is no plan or intention to revoke or otherwise terminate the S corporation election of any Controlled Corporation.

RULINGS

Based solely on the information submitted and the representations made, we rule as follows regarding the Proposed Transactions:

- (1) Each Contribution, together with its respective Distribution, will be a reorganization within the meaning of § 368(a)(1)(D). With respect to each such reorganization, Distributing and the respective Controlled Corporation will be "a party to a reorganization" within the meaning of § 368(b).

- (2) No gain or loss will be recognized by Distributing on the Contributions (§§ 357(a) and 361(a)).
- (3) No gain or loss will be recognized by any of the Controlled Corporations on the Contributions (§ 1032(a)).
- (4) The basis of each asset received by each of the Controlled Corporations in the Contributions will equal the basis of that asset in the hands of Distributing immediately before the Contributions (§ 362(b)).
- (5) The holding period of each asset received by each of the Controlled Corporations in the Contributions will include the period during which Distributing held the asset (§ 1223(2)).
- (6) No gain or loss will be recognized by (and no amount otherwise will be included in the income of) Shareholder 1, Shareholder 2, Shareholder 3, Shareholder 4, Shareholder 5, or Shareholder 6 on their receipt solely of the stock of a respective Controlled Corporation in the Distributions (§ 355(a)).
- (7) No gain or loss will be recognized by Distributing in connection with the Distributions (§ 361(c)(1)).
- (8) The aggregate basis of the stock of Controlled 1 received by Shareholder 1; Controlled 1 received by Shareholder 2; Controlled 2 received by Shareholder 3; Controlled 2 received by Shareholder 4; Controlled 3 received by Shareholder 5; and Controlled 3 received by Shareholder 6, will each equal the aggregate basis of the Distributing stock surrendered by each Shareholder in exchange therefor, allocated in accordance with § 1.358-2(a) (§ 358(a) and (b)(2)).
- (9) The holding period of the stock in the respective Controlled Corporation received by each Shareholder in the Distributions will include the holding period of the Distributing stock surrendered in exchange therefor, provided the Distributing stock was held as a capital asset on the date of the Distributions (§ 1223(1)).
- (10) The earnings and profits of Distributing, if any, will be allocated to each of the Controlled Corporations in accordance with § 312(h) and § 1.312-10(a).

- (11) Distributing's momentary ownership of the stock of the Controlled Corporations, as part of the reorganization under § 368(a)(1)(D), will not cause the Controlled Corporations to have an ineligible shareholder for any portion of its first taxable year under § 1361(b)(1)(B). If the Controlled Corporations otherwise meet the requirements of a small business corporation under § 1361, the Controlled Corporations will be eligible to elect to be subchapter S corporations under § 1362(a) for their first taxable year.

CAVEATS

No opinion is expressed about the tax treatment of the Proposed Transactions under other provisions of the Code and regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transactions that are not specifically covered by the above rulings. In particular, no opinion is expressed regarding:

- (i) Whether the Distributions satisfy the business purpose requirement of § 1.355-2(b);
- (ii) Whether the Distributions are being used principally as a device for the distribution of the earnings and profits of Distributing or the Controlled Corporations;
- (iii) Whether the Proposed Transactions are part of a plan (or series of related transactions) under § 355(e)(2)(A)(ii);
- (iv) The tax results from the conversion of LLC to an entity taxable as a partnership upon contribution of the LLC interests by Distributing to the Controlled Corporations; and
- (v) The application of § 1374 to any of the Controlled Corporations.

PROCEDURAL STATEMENTS

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of this letter ruling.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Alison G. Burns
Branch Chief, Branch 2
Office of Associate Chief Counsel (Corporate)